Bureau of Competition Policy

Statement

NOTES FOR REMARKS TO THE ADVISORY COUNCIL ON THE INFORMATION HIGHWAY

BY

GEORGE N. ADDY

DIRECTOR OF INVESTIGATION AND RESEARCH

BUREAU OF COMPETITION POLICY

OTTAWA, JUNE 15, 1994

Check Against Delivery

Government of Canada Gouvernement du Canada

Canada

Dr. Johnston, members of the Advisory Council, ladies and gentlemen. It is a pleasure for me to have this opportunity to meet with you this evening. I'll keep my remarks to essentials, and then respond to questions.

I have been asked to speak about the relationship between competitive markets and the development of the information highway. This, I will do from two perspectives:

- that of Director of Investigation and Research responsible for the administration and enforcement of the *Competition Act*; and
- that of advisor on competition policy to the government and to Minister Manley.

In the latter role, I share with you the responsibility of advising the government. I'd like to start from this broader competition policy perspective and offer some observations I've drawn from my involvement in case matters in this area.

My first observation, which you will concur with, is that the information highway is happening now.

In this regard I disagree with Mr. Spicer's recent characterization of it as the information "hypeway". Such a characterization fails to reflect the dynamic nature of current developments. Also, I don't believe that industry leaders such as yourselves would be participants on this Advisory Council if it were concerned with hype.

The Information Highway is not a particular physical infrastructure awaiting government planning, approvals and spending. It is the exponentially growing capability of transmitting information and receiving it from virtually anywhere, at rapidly decreasing costs. The real news is not the fragmented transmission, but the multitude of commercial activities and opportunities emanating from this electronic world. The

highway is not a length of wire but a collage of networks and products in constant evolution.

That is why policy advisors must concentrate on enabling policies that address the future, not just on rearranging past policies to reflect today's environment.

The information highway that will exist a year from now, when reports are in and policy proposals, implemented, will seem very different from the information highway of today.

New policies must be oriented, as foreseen in Reinventing Government by Osborne and Gaebler, towards "steering" rather than "rowing" – to facilitate robust growth in Canadian markets of information services and technologies, with as few regulatory barriers as possible.

Many issues, which you will be called upon to assess, have attracted some public or media attention. For example, press reports suggest that the period of transition from regulated to fully competitive markets will be a hot topic for discussion when the government's proposals are tabled. In fact, the communications world has already been in transition, if not in turmoil, for some time. Consider telecom, not only in the marketplace, but also the regulatory regime context. One could start with the terminal attachment ruling back in 1982. Then, add reselling, long-distance competition, the *Broadcasting Act*, the *Telecommunications Act* and the current review of the regulatory framework.

The issue is not whether there should be phases to the transition which some suggest is just beginning. This sector has been in active "transition" from regulation to competition for the better part of a decade. The real task for policy advisors is to look ahead and advise government on how to facilitate and accelerate this transition.

My second observation, also significant in the context of policy, is that the information revolution is innovation-driven and leads to productivity gains and competitive advantage through the skillful application of advanced information technologies and services.

However, it is also my view that marketplace innovation cannot be managed. By that, I mean that the notion of introducing just "enough" competition in a marketplace to stimulate innovation is not where we should be going. Even if it were possible, which is not likely, the costs of error are tremendous. Quite simply, the more intense the marketplace rivalry, the greater will be innovation and its resultant economic benefits.

From the perspective of competition policy, technological innovation is good news. It tends to be pro-competitive: digitalization, compression and so forth do break down barriers between product and geographic markets and enhance market entry.

My third and last general observation from a competition policy perspective is that the marriage of computers to the information highway has created an "electronic marketplace". The combination of networks, computers, software and services is

producing totally new markets of buyers and sellers on a continental, even global, scale.

The policy implications are that new markets like these make it clear that the sorting out of issues involving the information highway extends beyond balancing of the interests of established, emerging and potential facilities providers. Policy advisors must also address the interests of providers of content and service, and of purchasers, of all those who make up the electronic marketplace of today and tomorrow.

Interestingly, the dynamic players of the electronic marketplace run the full range, from diminutive to colossal players. It is frequently suggested that policy advisors are swayed by traditional notions of the advantages of size and established prominence. They are apt to overlook that size means baggage too. For example, in competition law circles, it is noted that IBM, which avoided U.S. anti-trust action in the early 1980s, has fared much worse than AT & T, which was required to restructure radically.

Let's consider Internet, a component of the new marketplace. A year ago, I was of course aware of Internet, as were many others. But according to recent estimates, world-wide Internet users -- not just those who are aware and take an interest in Internet -- already number 30 million people, and that number is moving on to 35 million.* Internet provides me with new enforcement issues I have to face, which I believe illustrate the issues generated in this marketplace.

---

* Source: *Wired*, June 1994, p. 72.

As a law enforcement agency, we have concerns about misleading representations with respect to Internet. These fall under the false advertising provisions of the *Competition Act*. Let me illustrate my point with two examples. The first, reported in the *New York Times* of May 7, 1992, is about how two lawyers in Arizona advertised a "health product – super-oxygenated water" over Internet. They claimed for its users the benefits of accelerated healing and additional energy. Their pitch reached an audience of millions, for probably less than $100.00. Adverse Internet user reaction was strong, but the principals claim the ad was very profitable all the same. That message probably reached Canadian Internet users. What can I do at this point, as an enforcement officer, if the claims were false?

The second example, mentioned in an April 22 story in the *Wall Street Journal*, was of an offer made over Internet, which is similar to what we have seen in some unlawful telemarketing scams. The pitch was for people to sign up as recipients of electronic junk mail and be paid $500/yr. To "sign up" however, one had to purchase a kit for $159. It turns out that there was no advertising clearinghouse set up yet, and no specific plan had been developed, and of course, no money could possibly flow until these steps were taken. The party making the pitch was well known to the Washington State Attorney General's Office and the courts for previous misleading advertising tactics. What happened when a disgruntled victim issued a warning over Internet? He was sued by the company for libel.

These two examples give an idea of the issues that policy advisors have to bear in mind.

On the face of it, our law addresses such activities. But what of the issues such practices raise? Who has jurisdiction? What tools do agencies need to take remedial action? And more fundamentally, should government police this type of activity or should victims seek their own remedies?

I will now share some thoughts with you from a competition law enforcement perspective, and particularly, my impressions on how these considerations apply to my statutory responsibilities for the enforcement of the *Competition Act*.

It is important to recognize that the competition law approach and application is fundamentally different from those of regulation. The *Competition Act* is a general law of general application, which pertains to all industries equally: from transportation, to the manufacturer of shoes, from petroleum products to communications.

Unlike economic regulation, competition law does not involve prior approval of business conduct. Competitive market focus, and not competition authorities, regulate levels of service, quality, prices or profits.

It is sometimes suggested that the removal of sectoral regulatory restrictions leaves a previously regulated sector exposed to all manner of anti-competitive practice. In fact, the *Competition Act* and other marketplace framework laws provide economy-wide rules.

The *Competition Act* establishes the boundaries between what Parliament has defined as acceptable business conduct and conduct it deems to be unlawful. Within these boundaries, firms are free to seek out market opportunities and conduct their affairs as they see fit.

Current Bureau files cover a range of activities, from criminal and civil enforcement initiatives to merger reviews, regulatory interventions and policy development.

There are a substantial number of ongoing matters involving the telecommunications sector and the electronic marketplace. You can expect that formal proceedings will be launched in the near future on some of these files. Let me however mention that the speed at which industry initiatives have developed has meant that, for some files, initial concerns were overtaken by industry and technological developments.

I want to emphasize that effective oversight of competitive and anti-competitive behaviour, as carried out in deregulating industries, of which yours is one, along with financial, insurance and transportation sectors, will require continued but realistic re-allocation of resources, in keeping with decreasing resources within government. This means that potentially unlawful anti-competitive behaviour which does not meet our strategic enforcement objectives, though this behaviour may have a direct impact on some parties, will not be pursued by the Bureau.

To continue on this matter of enforcement objectives, I'd like to elaborate on the six elements which I consider essential to a competitive electronic marketplace:

- First, legislative and regulatory impediments to competition – such as line-of-business restrictions imposed upon telephone companies, cable companies, broadcasters and others – must be reduced or eliminated. Firms should not be prevented from exploiting their technological and managerial edge in the marketplace. In a competitive situation, firms must be free to seek out market opportunities on the basis of their own assessments of the risks of failure and potential rewards.

Ministers Manley and Dupuy have indicated to this Council, publicly, on May 16, that the government should adopt such a pro-competition approach. As you know, the government's proposals for reform of the current regulatory regimes in this area are forthcoming.

- Second, one has to deal with essential facilities. Where any firm – telephone, cable or whatever – controls network facilities essential to competitive entry, obligations must be created for these firms to provide open access to these facilities on a non-discriminatory basis. These obligations should involve the development of common standards, open network architecture, co-location and unbundling of required services. Control of network facilities and proprietary standards should not be used to disadvantage rivals to the detriment of competition.

I might add that the issue of essential facilities is not simply a matter of whether there is one or more providers. If there are essential facilities, we will need some regime to deal with that, regardless of the number of firms. Duopoly and oligopoly market structures can be as susceptible to abuse of market power as monopolies.

- Third, there are issues involving vertical integration and corporate affiliation. Policies permitting telephone and cable companies to expand their range of services must also include requirements for them to provide network capacity to unaffiliated program and service providers on a nondiscriminatory basis.

Given the incentives for vertically integrated firms to favour their own services, appropriate safeguards, which could include some form of structural separation, will have to be designed and implemented.

As the entrants to the now-competitive long-distance voice transmission market will reach equal access on July 1, 1994, we are reminded that equal treatment from facilities providers, who are themselves competing in the services market, may require some form of oversight or ruling.

- The fourth element to address is cooperation among competitors. To the extent that collaboration and cooperation among various industry participants is needed to further develop the information highway, supervision may be required to ensure that any such arrangements do

not involve anti-competitive market sharing, or otherwise go beyond what is necessary to facilitate interconnection and open access.

The telecommunications industry, as in other industries, has seen the development of strategic alliances among various players.

Most strategic alliances will pose no competition concerns, because they do not give rise to market power or to undermining of competition.

The few that might do so would be reviewed under provisions of the *Competition Act* (such as conspiracy, abuse-of-dominance or merger-review provisions). I will not comment in detail on the matter, but the recent announcement concerning the DBS satellite alliance is an instance of an arrangement where I believe it is necessary to obtain greater information to determine the competitive impact of the proposal and whether there are issues that should be addressed under the Act.

- Fifth, competition in the provision of information facilities seems most likely to occur between cable and telephone companies. Therefore, mergers and acquisitions involving these firms, particularly in the same geographic market areas, will be subject to close and continuing scrutiny under the Act.

The merger review process under the Act must consider whether the transaction is apt to "substantially lessen or prevent competition". Given the pace of change in this sector, it is probable that a key focus of any analysis by the Bureau will be the likely prevention of competition of such transactions.

- And finally, the sixth element concerns cross-subsidization. As the information highway develops, options will, with time, emerge for competition in local telephone service. So as to induce efficient entry into the local loop, the current policy of pricing local service/access-below-cost and of relying on substantial contributions from other services, particularly long distance, will have to be reconsidered.

There are some points I would like to make about these six elements that are fundamental to a dynamic, competitive electronic marketplace.

One is that, despite the new technological forms of communications facilities and services markets, the essentials of competition analysis remain:

- a central concern about market power, and
- a lookout for anti-competitive structures and behaviour.

The other is that seeking to maximize opportunity and activity in the Canadian electronic marketplace does not have to be at odds with the other public policy objectives set out in Minister Manley's discussion paper on the Canadian information highway.

For example, current policies provide for the redirection of substantial funds from cable revenues to Canadian programming. Hence, there is concern that alternative market structures could jeopardize the security of that source of programming funding. However, there are a variety of means of collecting these funds; what matters is that the revenue base be as large as possible, which is best

accomplished by removing regulatory barriers to innovative development and growth. What we have to do is develop new methods of achieving objectives, such as support for Canadian programming, that do not impair the free operation of market forces.

I am of course not suggesting that all past regulation has been inappropriate. The success of Canada's telephone and cable systems is in part attributable to its policy framework. But change is needed. Redundant regulation will only give Canada's competitors time to catch up or fail to provide the stimulus needed to maintain the drive for innovation.

Nor am I suggesting that, in the future, there will be no need to consider any form of regulatory oversight beyond framework laws.

A number of awkward circumstances could arise in relation to one or more of the six competition factors I described. Essential facilities and cooperation among competitors are but two of them. Problematic circumstances such as these may have to be addressed by the CRTC.

The extent to which the Advisory Council can, in this environment, point the way to enhancing the prospects for vigorous and effective competition in the electronic marketplace will, in my view, be quite a challenge for you.

Let me now try to pull some of these perspectives together. Changing technology has made the original reason for regulating communications companies — that they were natural monopolies — obsolete. Technological advances have already allowed for competition in long-distance telecommunication services. These advances

amply demonstrate that competition is a more effective means than regulation to determine which services are offered to consumers, and at what prices.

Technology has also made it possible for communications companies to compete in new markets and, most significantly, it offers the prospect of their competing directly in their respective core markets.

Government legislation and regulation are adapting to this changing environment, as illustrated by numerous decisions by the CRTC to open telecommunications markets to competition, and the new *Telecommunications Act* which names competition as one of its primary objectives.

Now, the government is seeking advice on how to move forward, how to build momentum. The way I see it, to enhance Canada's international competitiveness through the creation and development of the electronic marketplace, we have to speed up the process by which convergence and competition are made possible. Continued regulatory protection in the absence of market failure or market power only inhibits the drive of Canadian firms towards efficiency, stifles innovation and delays the benefits that flow to users and consumers from a competitive marketplace.

Private companies must be encouraged to innovate, to take risks, and to reap the rewards when they succeed. The market will respond if they get it wrong.

With the rapid change in technology and trade, I do not believe that governments or their regulators can possibly choose the products, services or suppliers that would best meet the communications needs of Canadians. Competitive

market forces are most suited to fulfill these needs. I urge you to focus your efforts on ensuring that the barriers to competition are minimized, if not removed altogether.

By creating conditions which nurture vigorous and effective competition in the electronic marketplace, you will be securing the benefits of choice, at lower prices, for Canadian business and consumers.

I also urge you to focus on the regulatory regime that will hold sway in the future. There are many legitimate reasons for regulation. What is important for the government is, in my view, to have information at its disposal so as to be able to assess the market impact of any regulatory proposal, and be in a position to trade off policy objectives.

In closing, I will be happy to comment on the forthcoming policy proposals once they are released. Remember, my colleagues and I are available to brief you on any aspect of the *Competition Act* or the Bureau which you may wish explained to you in greater depth.

By the way, yes -- I am accessible on Internet. My address is:

compass2@achilles.net

You are most welcome to get in touch via Internet.

I wish you well with your very substantial challenge. Canadian communications have benefited before now from far-sighted explorations - and we are already more than 20 years down the road that was foreseen in *Instant World*, so it is now time for fresh thinking and guidance.

I hope that I have been able to provide you with some insight into the links between competition and communications. Thank you for giving me this opportunity.